

## TEACHERS' RETIREMENT BOARD

### INVESTMENT COMMITTEE

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|              |   |                                       |
|--------------|---|---------------------------------------|
| Subject:     | Credit Enhancement Program-<br>Multi-Family Housing | Item Number: <u>10</u>                |
|              |   | Attachment(s): <u>1</u>               |
| Action:      | <u>                    </u>                         | Date of Meeting: <u>April 5, 2000</u> |
| Information: | <u>    X    </u>                                    | Presenters: <u>Mr. Rose</u>           |

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### EXECUTIVE SUMMARY

One of the 1999-2000 Investment Branch Objectives was to "Design and develop a credit enhancement vehicle to be utilized in a multi-family housing program." This agenda item documents the CalSTRS approach to providing credit enhancement for housing projects. Historically, CalSTRS has provided confirming or direct pay letters of credit supporting banks in such transactions. The primary credit-underwriting test has been a review of the credit acceptability of the partner bank for each transaction.

One of the elements contained in the 1999/00 Credit Enhancement Business Plan was to assist financial institutions in the underwriting of construction and mini-term financing for multi-family housing transactions. In this portion of the credit enhancement program, some of the financial institutions have lower ratings than previous financial partners who take the direct credit risk. CalSTRS' staff intends to mitigate this risk applying direct risk credit analysis to the underlying transaction to ensure that the credit underwriting meets the quality standards established by CalSTRS. CalSTRS will complete credit underwriting to each multi-family housing project as well as the fronting financial institution. The credit underwriting standards will be developed from Standard and Poor's, Moody's, or Fitch rating agencies to ensure the elements of due diligence include management assessment, site visitation, and financial analysis of each project.

The expansion of credit enhancement for multi-family housing projects fits within the existing Credit Enhancement Program. This agenda item updates the Investment Committee of progress made to evolve the Credit Enhancement Program. More detailed information, including resource requirements, will be provided to the Investment Committee when the business plan is presented in June 2000.

## **BACKGROUND**

CalSTRS commenced its study to develop what is now called the Credit Enhancement Program in the fourth quarter of 1991. The original intent in studying the program was to explore whether CalSTRS could generate fee income by assisting construction finance efforts for California public schools. It was determined that restrictions in the California Education Code prohibited such transactions at the time. From the research, however, it was considered appropriate for CalSTRS to generate fee income as a credit enhancer for public and private activity bonds in the State of California. Since that time, the California Education Code has been amended to allow CalSTRS to provide credit enhancement for California public schools and CalSTRS has done a number of such transactions.

Over the past 5½ years, CalSTRS has provided credit enhancements supporting over 100 California municipal issuers and private entities utilizing private activity bonds for industrial development, pollution control, healthcare, and multi-family housing. The following is a highlight of housing transactions that have been completed over the past 5 years and which amounts to approximately \$150 million.

## **CALIFORNIA HOUSING TRANSACTIONS CREDIT ENHANCED BY CALSTRS**

From a review of the Credit Enhancement Portfolio as of January 31, 2000, the following represent credit enhancement transactions supporting California Housing:

| Closing Date | Transaction               | Letter-of-Credit Type | CalSTRS' Commitment  | Comments        |
|--------------|---------------------------|-----------------------|----------------------|-----------------|
| Aug-94       | Bridge-Richmond Townhomes | Direct Risk           | \$1,575,750          | Redeemed Feb-97 |
| Apr-96       | Suncreek Apartments       | Confirming            | \$6,878,247          |                 |
| Oct-98       | The Terraces/Park Marino  | Confirming            | \$8,131,507          |                 |
| Mar-99       | City of Ontario 1996      | Confirming            | \$8,422,259          |                 |
| Mar-99       | City of Ontario 1997      | Confirming            | \$6,790,609          |                 |
| Apr-99       | CHFA 1998 Series P        | Bond Insured          | \$9,832,188          |                 |
| Apr-99       | CHFA 1998 Series T        | Bond Insured          | \$5,387,500          |                 |
| Apr-99       | CHFA 1998 Series M        | Bond Insured          | \$26,717,959         |                 |
| May-99       | St. Vincent de Paul       | Confirming            | \$7,595,737          |                 |
| Dec-99       | CHFA 1999 Series P & Q    | Direct Risk           | \$13,705,110         |                 |
| Dec-99       | CHFA 1999 Series O        | Bond Insured          | \$22,896,875         |                 |
| Jan-00       | CHFA 2000 Series C & D    | Bond Insured          | \$34,180,625         |                 |
|              |                           | TOTAL                 | <u>\$152,114,366</u> |                 |

## **SUMMARY OF HOUSING TRANSACTIONS**

### **BRIDGE-RICHMOND TOWNHOMES**

The purpose of this transaction was to provide 50% of a credit enhancement alongside Wells Fargo Bank to support a \$3.3 million construction loan to Bridge Housing Corporation for the construction of 34 townhomes in downtown Richmond, CA. The construction loan was taken out through the Federal Home Loan Bank's Affordable Housing Program. CalSTRS enhanced Bridge's obligation for 50% or \$1,575,750. The townhomes were sold by Bridge Housing Corporation and the credit obligation to CalSTRS ended in February 1997.

### **SUNCREEK APARTMENTS**

CalSTRS provided a confirming letter of credit for a multi-family refunding issued through the County of Sacramento. The funds were used to refinance a tax exempt multi-family bond to support the Suncreek Apartments which is a 268 multi-family housing project located in Citrus Heights, CA. The standby letter-of-credit bank has a first lien position on the property. The commitment expires April 2002.

### **THE TERRACES/PARK MARINO**

This transaction provided a confirming letter-of-credit replacement for bonds issued by the California Statewide Communities Development Authority for the Terraces at Park Marino Project located in Altadena. The Terraces is an 88 unit assisted living project designed for seniors. It is an affordable housing facility, which sets aside 20% of the units for seniors with incomes below 50% of the median income for Los Angeles, CA. Rent can be no more than 15% of the senior's income. The commitment expires October 2002.

### **CITY OF ONTARIO REDEVELOPMENT 1996 AND 1997**

CalSTRS provided confirming letters of credit to the Ontario Redevelopment Agency for the issuance of 1996 Series A Bonds and 1996 Series B Bonds for the acquisition and rehabilitation of affordable housing. The two bond issues support the Terrace View Apartments and the Parc Vista Apartments. Terrace View is a 75 unit multi-family housing project located at 1130 West 4<sup>th</sup> Street in the City of Ontario. The complex has studio and one-to-three bedroom units. Parc Vista Apartments is a 78 unit multi-family housing project located at 1206 West 4<sup>th</sup> Street in the City of Ontario. The complex has studio and one-to-two bedroom units. The commitment for both letters of credit expires March 2003.

### **SAINT VINCENT DE PAUL MANAGEMENT INC. (SVDP)**

This transaction provided funds for a bond issued by the California Statewide Communities Development Authority for the Saint Vincent de Paul Society of San Diego. The commitment expires May 2002. Proceeds were used to finance and refinance the development, acquisition, construction, renovation and improvement of a maintenance center, the headquarters of the corporation, and the following projects:

| <u>Project Name</u>               | <u>Project Description</u>   |
|-----------------------------------|--|
|                                   |  |
| Imperial Avenue                   | Joan Kroc/Bishop Maher Centers that service 450 homeless persons   |
| 3350 E Street                     | Two story building that is used as administrative offices and food warehouse   |
| Teen Center                       | Provides housing programs for homeless teens aged 14 to 18 including an onsite school, counseling and free medical and dental care |
| 33 <sup>rd</sup> Street Warehouse | Warehouse, thrift store, dispatch office and auction site  |
| Commercial Street Park            | Park to include play areas and a parking lot   |
| Sixteen Street Project            | Residences for guests and out-of-town visitors. Also used as meeting and conference facilities                                     |
| Fifteenth Street Project          | 350-bed seasonal shelter   |
| Affordable Housing                | Nine single family residences and commercial properties for the development of affordable housing residences and office space      |

### **CALIFORNIA HOUSING FINANCE AGENCY (CHFA) 1999 SERIES O, P, Q**

CalSTRS provided a liquidity agreement to support a \$136.6 million liquidity facility to CHFA. CHFA was created in 1975 for the purpose of meeting the housing needs of persons and families of low or moderate income. CHFA issues a combination of tax-exempt, taxable fixed and floating rate debt to create a pool of funds for the purpose of making home ownership more affordable to low income residents of the State.

CalSTRS participated in 25% of the transaction or \$34.1 million. The funds for the 1999 Series O Bonds enable CHFA to make and/or purchase eligible mortgage loans. The proceeds of the 1999 Series P and Q Bonds were used along with revenue and income to redeem outstanding fixed rate Home Mortgage Revenue Bonds. CHFA redeemed these bonds by acting on a 10-year optional call provision. CHFA is refinancing the existing 1989 mortgages with tax-exempt variable rate debt. The underlying mortgages of the 1999 Home Mortgage Revenue Series O, P, and Q Bonds are all insured by FHA, VA and other insurers. The bonds are also supported by the reserves of the Housing Revenue Bonds program, and are guaranteed by an AAA bond insurer (AMBAC). CHFA is rated Aa2 by Moody's and AA by S&P. The commitment expires in July 2001.

## **CALIFORNIA HOUSING FINANCE AGENCY (CHFA) 1998 SERIES P, T, M**

CalSTRS provided a liquidity agreement to support a \$168 million liquidity facility to CHFA. CalSTRS participated in 25% of the transaction, or \$42 million. The transaction will provide liquidity for the variable rate portion of the 1998 issue. The underlying mortgages that the bonds support are all insured by FHA, VA and other insurers. The bonds are also supported by the reserves of the Housing Revenue Bonds program. In addition, AAA bond insurers guarantee the Bonds: 1998 Series P (FSA); 1998 Series T (AMBAC); and 1998 Series M (MBIA). CHFA is rated AA- by Standard & Poor's and rated Aa3 by Moody's. The commitment expires in July 2001.

## **CALIFORNIA HOUSING FINANCE AGENCY (CHFA) 2000 SERIES C, D**

CalSTRS provided a liquidity agreement to support a \$127.5 million liquidity facility. CalSTRS participated in 25% of the transaction or \$31.8 million. The Series C and D Bonds are being issued to make funds available for CHFA to make or purchase eligible mortgage loans secured by first mortgages on newly constructed and existing single family homes. The underlying mortgages of the 2000 Home Mortgage Revenue Series C and D Bonds are insured by FHA, VA and the California Housing Loan Insurance Fund (CaHLIF). In addition, Series C and D Bonds are guaranteed by an AAA bond insurer (FSA). CHFA is rated Aa2 by Moody's and AA by S&P. This commitment expires January 2003.

## **CONCLUSION**

Over the past several years, many opportunities have been presented to provide credit enhancement for multi-family housing projects that had existing fronting financial institutions, but which did not meet the credit quality targets of the credit enhancement program. These opportunities were not considered and no attempt was made to underwrite the creditworthiness of the underlying project.

This subset of multi-family housing transactions can be executed under the existing Credit Enhancement Policies and Procedures, and can be an opportunity to expand the credit enhancement program if CalSTRS is willing to utilize more staff resources in performing due diligence. This requires that CalSTRS dedicate the appropriate staff to provide underwriting and due diligence comparable to that performed in a direct risk transaction.

Required underwriting tasks would include:

- Assessment of management (project owner)
- Site visit
- Financial analysis of the project
- Application of underwriting standards offered by either Standard & Poor's, Moody's, or Fitch rating agencies to ensure that the project is investment grade.

More detailed information, including staffing requirements, will be provided to the Board when the business plan is presented in June 2000.